Supreme Court, U.S.
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No. 99-

IN THE

Supreme Court of the United States

PORT JEFFERSON HEALTH CARE FACILITY, *et al.*,

Petitioners,

v.

BRIAN WING, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS, STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI

RICHARD D. POMP
Visiting Professor of Law
Harvard Law School
Areeda 126
Cambridge, MA 02138
(617) 496-8685

RICHARD HAMBURGER
Counsel of Record
HAMBURGER, MAXSON & YAFFE, LLP
225 Broadhollow Road
Suite 404W
Melville, NY 11747
(631) 694-2400

Attorneys for Petitioners

Of Counsel:

RICHARD HAMBURGER
LANE T. MAXSON
RICHARD D. POMP
DAVID N. YAFFE

159342

Counsel Press LLC
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

This nation faces a crisis in the financing of its health care, an issue that will dominate the political agenda for the coming decade. One consequence of this crisis is that New York chose to finance its Medicaid program in a way that subverted the workings of representative government and that ingeniously and deviously bypassed the normal political accountability of the legislative process.

New York is not alone in devising a cunning scheme to isolate politically marginal taxpayers, such as Petitioners, and sacrifice them in order that others could be held harmless from a special tax. At least seven other states have adopted similar approaches and more can be expected to follow suit if the decision below is allowed to stand.

The question presented is whether New York's exploitative scheme can survive equal protection analysis. Specifically, do the core values of the democratic process, articulated most recently by this Court in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), require a more stringent application of the "rational basis" test where, as here, the majority of New York's for-profit nursing homes have been "bought off" by the State so that a small minority of for-profit nursing homes bear the full brunt of a special tax to fund the State's Medicaid obligations.

PARTIES TO THE PROCEEDINGS

The Petitioners are: Port Jefferson Health Care Facility, Birchwood Health Center, Carillon House Nursing Facility, Little Flower Nursing Home, Nesconset Nursing Center, Patchogue Nursing Center, Petite Fleur Nursing Home, St. James Nursing Home, St. James Plaza Nursing Facility, Sunrest Health Facilities, Inc., Riverhead Nursing Home, Central Island Health Care, Glengariff Health Care Center, Grace Plaza of Great Neck, Inc., South Shore Healthcare, Sunharbor Manor, Woodbury Nursing Home, Port Chester Nursing Home, Maplewood Nursing Home, Meadowbrook Nursing Home, and Albany Avenue Nursing Home.

The Respondents are Brian J. Wing, Acting Commissioner of the New York State Department of Social Services, Barbara Ann DeBuono, M.D., M.P.H., the Commissioner of the New York State Department of Health, and the State of New York.

STATEMENT PURSUANT TO RULE 29.6

The Petitioners are a combination of sole proprietors, partnerships and corporations. None of the corporate Petitioners has a parent company and no publicly held company owns 10% or more of the stock of any such corporate Petitioner.

TABLE OF CONTENTS

	Page
Question Presented	i
Parties To The Proceedings	ii
Statement Pursuant To Rule 29.6	ii
Table of Contents	iii
Table of Cited Authorities	v
Table of Appendices	viii
Opinions Below	1
Statement Of Jurisdiction	1
Constitutional And Statutory Provisions Involved	2
Statement Of The Case	2
A. Brief Statement.	2
B. The Challenged Assessments.	5
C. Seven Other States Have Identical "Tax And Refund" Provider Taxes.	6
D. The Decisions Of The Courts Below.	9

Contents

	Page
Reasons For Granting The Writ	11
I. The Decision Below Applied The Wrong Level Of Scrutiny To Petitioner's Equal Protection Challenge	11
A. Summary of Argument.	11
B. Argument.	13
Conclusion	22

TABLE OF CITED AUTHORITIES

Page

Cases:

Clinton v. City of N.Y., 524 U.S. 417 (1998) 4

DeBuono v. NYSA-ILA Med. & Clinical Servs. Fund, 520 U.S. 806 (1997) 13

Kovacs v. No. 9, 336 U.S. 77 (1949) 17

Miriam Osborn Memorial Home Ass'n v. Chassin, 240 A.D.2d 143 (2d Dept), *appeal dismissed*, 92 N.Y.2d 919 (1998) 13

Nordlinger v. Hahn, 505 U.S. 1 (1992) 11

Railway Express Agency, Inc. v. N.Y., 336 U.S. 106 (1949) 16

West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994) .....i, 5, 17, 18, 19, 20, 21

United States Constitution:

Fifth Amendment 21

Fourteenth Amendment 2

Cited Authorities

	Page
Statutes:	
Ala. Code § 40-26B-21	7
Ala. Code § 40-26B-27	7
Ind. Code Ann. § 12-15-32-11	9
La. Rev. Stat. Ann. § 2625 (West 2000)	8
Minn. Stat. Ann. § 256.9657	8
Mo. Ann. Stat. § 198.401	7
Mo. Ann. Stat. § 198.431	8
Mont. Code Ann. § 15-60-102	8
1997 N.Y. Laws, c. 389, §§ 197-97	6
1999 N.Y. Laws, c. 407, pt. CC, § 4	6
NY CPLR § 5601(d)	1
N.Y. Public Health Law § 2807-d	2
28 U.S.C. § 1257(a)	1
Utah Code Ann. § 26-35-104 (1999)	8

Cited Authorities

Page

Other Authorities:

42 C.F.R. § 433.68(b)(3) 4

John Hart Ely, Democracy and Distrust: A Theory of Judicial Review, chs. 4-5 (1980) 18, 19

Pomp and Oldman, State and Local Taxation 2-1 (3d ed. rev. 2000) 21

TABLE OF APPENDICES

	Page
Appendix A — Opinion And Order Of The Court Of Appeals For The State Of New York Dated And Decided December 16, 1999	1a
Appendix B — Order Of The Supreme Court Of The State Of New York Dated And Filed January 26, 1999	16a
Appendix C — Decision And Order Of The Supreme Court Of The State Of New York, Appellate Division, Second Judicial Department Dated August 31, 1998	25a
Appendix D — Memorandum Of The Supreme Court Of New York, Suffolk County Dated June 30, 1997	30a
Appendix E — Counter Proposed Order Of The Supreme Court Of The State Of New York Dated August 27, 1997	47a
Appendix F — Relevant Statutes	52a

Petitioners respectfully request that a writ of certiorari issue to review the decision of the New York Court of Appeals.

OPINIONS BELOW

The opinion of the New York Court of Appeals for which review is sought is reported at 94 N.Y.2d 284 and is reprinted in the Appendix hereto ("App.") at App. "A," pp. 1a-15a. The opinion of the New York Appellate Division is reported at 253 A.D.2d 548 and is reprinted at App. "C," pp. 25a-29a. The opinion of the New York Supreme Court, Suffolk County, is unreported and is reprinted at App. "D," pp. 30a-46a.[1]

STATEMENT OF JURISDICTION

The judgment of the New York Court of Appeals was filed on December 16, 1999. Petitioners' time to file a certiorari petition in this Court was extended to May 15, 2000 by order of Justice Ruth Bader Ginsburg dated March 1, 2000 (A-99-3-703). Petitioners invoke this Court's jurisdiction under 28 U.S.C. § 1257(a).

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1. Appendix "B" (pp. 17a-24a) consists of the final order entered in the Supreme Court, Suffolk County, after affirmance in the Appellate Division (App. "C"), which allowed Court of Appeals review (App. "A") of the prior non-final Appellate Division order. *See* NY CPLR § 5601(d). Appendix "E" (pp. 48a-51a) consists of the initial order of the Supreme Court, Suffolk County, issued in connection with that court's earlier opinion (App. "D"), which was affirmed by the Appellate Division (App. "C").

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent provisions of N.Y. Public Health Law § 2807-d are reprinted at App. "F."

The Equal Protection Clause of the Fourteenth Amendment provides that: "[n]o State shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1.

STATEMENT OF THE CASE

A. Brief Statement.

Petitioners are 21 New York State nursing homes who challenged the constitutionality, on equal protection grounds, of two health care provider taxes imposed by the State on the facilities' gross receipts. The New York Supreme Court and the New York Appellate Division agreed with Petitioners and declared the taxes unconstitutional because they did not fall uniformly upon the nursing homes and because no rational justification supported the lack of uniformity. The New York Court of Appeals reversed and held the challenged statutes constitutional.

The lack of uniformity was created by a critical feature of the tax program: That portion of the tax levied and collected on a nursing home's Medicaid revenues — *and Medicaid revenues only* — was returned to each nursing home (dollar-for-dollar) by increasing the home's Medicaid reimbursement in an amount *equal* to the tax collected on those Medicaid revenues.

Approximately 80 percent of New York nursing home residents have their care paid for through Medicaid, but many homes are either far above or far below this state wide average, depending upon each nursing home's particular mix of residents — Medicaid, Medicare, private pay, Veteran's Administration or insurance. As a result, the majority of the homes in the State, which receive 80 percent or more of their revenue from Medicaid, are effectively held harmless from the tax, while the minority of the homes in the State which, like Petitioners, receive large proportions of their revenues from non-Medicaid sources, shoulder the greatest burden of the tax.

Faced with a burgeoning Medicaid financing crisis, New York had enacted the challenged "tax and refund" scheme to cost-shift a significant portion of the Medicaid program from New York State to the federal government. The scheme works by exploiting the fact that the federal government funds 50 percent of the Medicaid program in New York. For every $100 million of tax collected, approximately $80 million was returned to the nursing homes by way of increased Medicaid rates, and approximately half of that increase — $40 million — was paid by the federal government. Using these numbers as an illustration, even though the State refunds $80 million of every $100 million in tax collected, the State still clears $60 million, which is collected from the federal government ($40 million) and from the nursing homes ($20 million collectively, *but not uniformly*).

This device to milk the federal treasury is not unique to New York. It is employed in at least seven other states, where

federal financial participation in the Medicaid program is often *70 or 80 percent*.[2]

The constitutional evil presented by this case, occurring elsewhere in the nation and likely to spread, is politically expedient discriminatory tax legislation that fundamentally bypasses the usual checks and balances that govern such legislation. Put simply, absent the Medicaid reimbursement component, one could expect that the challenged assessments would be opposed by *all* nursing homes subject to the tax as they would be uniformly subject to the tax levy. However, once the State proposed to return all assessments collected on Medicaid receipts — a skewed and heavily disproportionate refund of 80 percent of the taxes collected state wide — and threatened, in the alternative, to enact massive across-the-board cuts in Medicaid reimbursement rates, the political dynamic of the proposal necessarily changed. The majority of nursing homes whose Medicaid occupancy rates are at the top of the scale, effectively

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2. This federal cost-shifting scheme received some notoriety in New York in recent years. Under federal law, health care provider taxes must be "uniform" and "broad based." *See* 42 C.F.R. § 433.68(b)(3). For years, New York had submitted waiver applications with respect to these requirements for a number of provider taxes, including the nursing home taxes in issue here. Those waiver requests were never acted upon by the federal government. In 1997, Senator D'Amato attached to the Balanced Budget Act of 1997 a provision that all health-care related taxes for which New York had applied for a waiver would be deemed permissible provider taxes. This set the stage for the very first exercise of a presidential veto under the Line Item Veto Act and the decision of this Court in *Clinton v. City of N.Y.*, 524 U.S. 417 (1998), holding the act to be unconstitutional. The recoupment amount, from which New York was thus held harmless by the legislation, was estimated to be $2.6 billion.

"mollified" as suggested in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), would now support the program as tailored to their interests, while any opposition by the minority of nursing homes, members of the same taxed class whose Medicaid occupancy rates were at the lowest end of the scale, would be overridden.

In short, the discriminatory tax legislation which is the product of a corrupted political process cannot be allowed to stand.

B. The Challenged Assessments.

The New York Court of Appeals fairly summarized the statutes in issue in its opinion reversing the lower New York courts:[3]

> The State first assessed a tax on the gross receipts of RHCFs for the period January 1, 1991 to March 31, 1992, at the rate of .6%, with no reimbursement (L 1990, ch 938, § 28). The statute creating the assessment specifically provided that the tax was not a recoverable Medicaid expense (*see*, Public Health Law § 2807-d[10][a]). Thus, in the original RHCF gross receipts legislation, the burden of the tax was imposed uniformly on all of the gross receipts of all RHCFs, regardless of source. The .6% original assessment is not at issue on this appeal.

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3. The court's opinion refers to "RHCFs" (*i.e.*, Residential Health Care Facilities) which are one and the same as nursing homes).

> In 1992, the Legislature extended the original .6% assessment and imposed an "additional assessment" of 1.2% (L 1992, ch 41, § 5; Public Health Law § 2807-d[2][b][ii]). That enactment provided, however, that contingent upon all Federal approvals necessary for Federal financial participation in the State's Medicaid program, the additional 1.2% assessment as applied to RHCF Medicaid receipts would be a reimbursable cost of care (*id.*, § 11; Public Health Law § 2807-d[10][b]). In 1995, the Legislature enacted a "further additional assessment" of 3.8% on RHCF gross receipts, and again provided that, contingent upon Federal approvals, that tax paid on Medicaid receipts would be a reimbursable expense (L 1995, ch 2, § 136; Public Health Law § 2807-d[2][b][iii]).

App. 1a-2a.

C. Seven Other States Have Identical "Tax And Refund" Provider Taxes.

Although New York's assessment program has now ended[4] there are at least seven other states that employ the

4. After the New York Supreme Court declared the "additional assessment" and "further additional assessment" to be unconstitutional on June 30, 1997 (App. "D"), the Legislature began to phase out the assessment program which finally ceased as of January 1, 2000. *See* 1997 N.Y. Laws, c. 389, §§ 197-97, and 1999 N.Y. Laws, c. 407, pt. CC, § 4. Nonetheless, the action is not moot for three reasons: first, at least seven other states employ similar schemes; second, more states can be expected to adopt such programs

(Cont'd)

same "tax and refund" scheme to shift Medicaid program costs to the federal government in a manner that discriminates against facilities with the lowest Medicaid occupancy rates. In Alabama, Missouri, Minnesota, and Louisiana, the statutes reflect both the "tax" and the "refund." In Utah, Montana, and Indiana, the statutes reflect only the tax. However, our conversations with officials in the State agencies confirm that as a matter of administrative practice, the amount of tax paid on Medicaid revenues is allowed as a Medicaid cost reimbursement.

In Alabama there exists a privilege tax on nursing facilities. The tax is imposed at an annual rate of $999.96 for each bed in the nursing facility. The privilege tax is specifically defined as an "allowable cost" under Medicaid reimbursement methodology. It is calculated into the Medicaid per diem rate for each nursing facility. *See* Ala. Code § 40-26B-21. In other words, when the bed is occupied by a Medicaid patient, the nursing facility is reimbursed through Medicaid. The statute provides that the tax shall not apply if federal matching funds are unavailable. *See* Ala. Code § 40-26B-27.

The State of Missouri imposes a nursing facility reimbursement allowance for the privilege of engaging in the business of providing nursing facility services. *See* Mo. Ann. Stat. § 198.401. The stated purpose of the

(Cont'd)

if the New York Court of Appeals' decision is left standing; and, third, Petitioners each sought and were initially awarded refunds of the unconstitutional assessments paid, less monies previously reimbursed as a reimbursable Medicaid cost (App. "B," pp. 17a-24a). The New York Court of Appeals reversed and vacated this grant of relief (App. 14a-15a).

allowance is to reimburse nursing facilities with matching federal Medicaid funds. The allowance ceases to apply if federal financial participation becomes unavailable. *See* Mo. Ann. Stat. § 198.431.

In Minnesota there is a nursing home license surcharge. The surcharge is imposed at an annual rate of $625 per licensed bed. *See* Minn. Stat. Ann. § 256.9657. Originally there was a provision which declared that the surcharge was not an allowable cost for Medicaid purposes, but that provision was repealed in 1992 and the surcharge is now reimbursed as an allowable Medicaid cost.

Louisiana has created a medical assistance trust fund. The Fund is sustained by fees imposed on health care service providers of various kinds. *See* La. Rev. Stat. Ann. § 2625 (West 2000). With respect to nursing facilities, the fee is set at a maximum of $10 per occupied bed per day. Section A(2) of the statute specifically provides that the fee shall be an allowable cost to be included in a facility's Medicaid reimbursement rate.

The State of Utah imposes an assessment on each nursing facility in the amount of $1.83 per patient day. *See* Utah Code Ann. § 26-35-104 (1999). According to officials in the Utah Dept. of Human Services, the assessment is included in the Medicaid reimbursement rate to nursing facilities.

Montana has a utilization fee which is assessed against nursing facilities in the amount of $2.80 per bed day. *See* Mont. Code Ann. § 15-60-102. Conversations with officials in the Montana Dept. of Public Health and Human Services reveal that the fee is reimbursed to facilities as an "allowable cost" through Medicaid.

Indiana imposes an assessment upon the annual gross revenues of intermediate care facilities for the mentally retarded. *See* Ind. Code Ann. § 12-15-32-11. The assessments are deposited in a Medicaid assessment account and refunded to facilities only for Medicaid services. The assessment terminates if federal financial participation becomes unavailable.

In every one of these states, the federal "free lunch" (a contribution of 50 to 80 percent toward the cost of State's Medicaid program) is being exploited through provider taxes, functionally identical to the assessments challenged here, that are refunded as Medicaid cost reimbursements. As the national health care financial crisis intensifies, more state legislatures can be expected to yield to the fiscal pressures which encourage them to band together with providers whose revenues derive primarily from the Medicaid program (the vast majority of providers) to impose these politically expedient and discriminatory taxes upon providers whose Medicaid clientele is *not* the primary source of their income (the minority of providers) as a means to balance budgets without painful but *nondiscriminatory* across-the-board tax increases or across-the-board Medicaid funding cuts.

D. The Decisions Of The Courts Below.

In a memorandum decision dated June 30, 1997, the New York Supreme Court granted Petitioners' motion for declaratory and injunctive relief (App. "D"). The court observed, "[D]efendants advance no argument that the inequality resulting from the imposition is justified by any reason of policy; their only premise is that the tax is rationally related to the State's interest in raising revenue" (App. 44a).

In affirming the New York Supreme Court, the New York Appellate Division cited the oft-stated proposition governing equal protection analysis in the field of taxation: "To meet equal protection criteria . . . , there must be general uniformity of treatment of those similarly situated, the classifications for disparity must be reasonable, and the taxes imposed must be uniform within the class" (App. 27a). The Appellate Division observed:

> The challenged assessments are not uniformly imposed and do disparately impact taxed [nursing homes], despite the fact that all are engaged in the same activity and, by Federal regulations, are required to provide the same quality of care (*see* 42 CFR 483.12[7][c][1]). The greater the proportion of Medicaid services provided by a [nursing home], the greater the proportion of that particular [nursing home's] gross receipts assessments would be reimbursed by the State. Thus, those facilities having a large Medicaid population have the majority of their revenues not subject to assessments (beyond the initial assessment of 0.6%), while [nursing homes] like the plaintiffs, having a large proportion of gross receipts from non-Medicaid sources, must shoulder the burden of the assessments (at the effective rate of 5.6%). The disparate treatment of similarly-situated [nursing homes] is based solely on the source from which the revenue was received.

App. 28a.

The New York Court of Appeals reversed and upheld the constitutionality of the challenged assessments (App. "A"). The court reasoned that a statutory classification will be upheld if any "reasonably conceivable" state of facts could provide a rational basis for the classification (App. 6a). The court rejected as "courtroom factfinding" (App. 7a) the findings of the two lower New York courts rejecting the State's three proffered justifications for the unequal treatment — namely: (1) that nursing homes with greater proportions of non-Medicaid residents were purportedly more profitable and, therefore, capable of shouldering the burden of the challenged assessments; (2) that nursing homes were allegedly able to raise the rates for their non-Medicaid residents in order to recoup the tax; and (3) that the State supposedly wanted to encourage facilities to accept more Medicaid patients.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION BELOW APPLIED THE WRONG LEVEL OF SCRUTINY TO PETITIONER'S EQUAL PROTECTION CHALLENGE

A. Summary of Argument.

The New York Court of Appeals applied too deferential a standard in evaluating the equal protection challenge by the Petitioners, accepting any "reasonably conceivable" state of facts that could justify the discriminatory treatment (App. 6a). Citing *Nordlinger v. Hahn*, 505 U.S. 1, 11 (1992), the court applied the rational basis standard, but described it as "especially deferential in the context of classifications made by complex laws" (App. 5a).

Petitioners concede that in most cases such an entirely deferential level of scrutiny would be appropriate to apply. For example, a taxing measure of general applicability whose revenues went into general revenue, subject to the normal spending processes of the legislature, is properly tested by such a standard. Indeed, the Petitioners did not challenge, for example, New York's initial 0.6 percent assessment on nursing homes, as all the proceeds from that tax were paid into the State's general fund, where they were subject to the normal legislative tugs and pulls on how such revenue should be spent.

What is different, however, about the 1.2 percent and 3.8 percent additional and further additional assessments that the Petitioners challenged was the Legislature's tying the funds raised from these assessments to the spending of such funds — namely, to the reimbursement of 100 percent of the tax levied on Medicaid receipts as a reimbursable Medicaid cost. The majority of nursing homes that would ordinarily have opposed the tax were "bought off" because they were offered reimbursement for that portion of each assessment that was levied on their Medicaid revenues in lieu of an across-the-board reduction in Medicaid payment rates.

By linking the assessments to the Medicaid cost reimbursement, the Legislature subverted the workings of representative government and avoided the normal political accountability that marks the legislative process. The normally deferential rational basis standard of review must be heightened under these circumstances.

B. Argument.

In an unrelated New York case in which the same assessment statutes were challenged, *Miriam Osborn Memorial Home Ass'n v. Chassin*, 240 A.D.2d 143 (2d Dept), *appeal dismissed*, 92 N.Y.2d 919 (1998), the New York Appellate Division noted:

> There is no escaping the conclusion that the [assessment program] was designed to deal with budget gaps caused by Medicaid expenses [and] was enacted when New York was "faced with the choice of either curtailing its Medicaid program or generating additional revenue to reduce the program deficit."

240 A.D.2d at 148, *citing DeBuono v. NYSA-ILA Med. & Clinical Servs. Fund*, 520 U.S. 806 (1997).

The transparency of the scheme — to levy taxes and then reimburse the bulk of the monies collected — and its political expediency as an alternative to massive Medicaid rate reductions, was judicially acknowledged and has *never been denied*:

> Although assessments are not normally regarded by the payer as a benefit, here the benefit was in the form of an ameliorative action in that the assessments were imposed *instead of the vastly more painful alternative of a three hundred million dollar cut in Medicaid reimbursement rates.*

Miriam Osborn, 240 A.D.2d at 144, n.1 (*citing*, letter of Richard N. Gottfried, Chairman of the New York State Assembly Committee on Health, January 22, 1991) (emphasis added).

In other words, to deal with this budget crisis, New York developed an ingenious approach for raiding the federal fisc, an approach that avoided a conventional across-the-board tax increase on all nursing homes or its logical alternative, a conventional across-the-board reduction of all nursing home reimbursement rates. The key to raiding the fisc was the exploitation of Medicaid — a federal program that subsidizes state financing of health care costs, including nursing home care. A tax on nursing home gross receipts could be expressly made a reimbursable cost under Medicaid. Through this mechanism, that portion of the assessment levied on a nursing home's Medicaid revenues (80 percent on a state wide average) — was then returned to such nursing homes, dollar-for-dollar, by increasing the State's Medicaid reimbursement in an amount equal to the taxes collected.

From the perspective of a nursing home with virtually 100 percent Medicaid occupancy, there would be no increase in operating costs. Thus, a nursing home with only Medicaid residents would be held completely harmless from the tax as the amount the nursing home paid in the assessment would be returned dollar-for-dollar. Clearly, under normal circumstances, no rational state would bother imposing such a tax where all of it would be returned.

But what made this an exceptional situation was the existence of the federal program that reimbursed New York for a percentage of the "refunds" that it paid to the nursing homes as part of the State's Medicaid program. Specifically, the federal government's share of such payments is approximately 50 percent, the State's share is approximately 40 percent, and local government's share is approximately 10 percent. Under these circumstances, New York would actually be better off for imposing a tax that it gave back to taxpayers (*even 100 percent of it*) than it would have been had the State never levied the tax at all.

To illustrate, if the State levied an assessment *limited* to Medicaid revenues and raised $100 million, which the State then *fully* reimbursed by way of increased Medicaid rates, only $40 million of the reimbursement would have come from State dollars. The State would have received a net benefit of $60 million from what would otherwise have been a "wash" — tax receipts of $100 million and Medicaid cost reimbursements of $100 million. In this situation, if not for the federal subsidy, New York would never bother with the meaningless act of levying and refunding 100 percent of an assessment. It is only the linkage of the assessment scheme to *federal* reimbursement that makes the tax palatable both to the State and the majority of nursing homes who have the highest occupancy rates for Medicaid clients.

The success of the ingenious New York scheme, however, was dependent on the 1.2 percent and 3.8 percent assessments satisfying certain federally imposed conditions. Two of those conditions required that the assessments be "broad based" and "uniform" (*see*, p. 4, n.2, *supra*). Accordingly, it was necessary to levy the assessments on *all* nursing homes, including those that were not reimbursed for the assessments because they had no Medicaid residents. And it was the necessity of imposing the assessments on all nursing homes and all nursing home revenues that creates the constitutional defect in the scheme.

For example, one of the Petitioners, Albany Avenue Nursing Home ("Albany Avenue"), has no Medicaid residents and, as a consequence, paid the assessment yet received no reimbursement (App. 43a). Albany Avenue thus bore the complete burden of the assessment so that the State

of New York could benefit through the scheme of linking the two assessments with the reimbursement of Medicaid costs. In this fashion, the actual net effect of the assessments is not borne by the taxpayers of the State nor by nursing homes as a class, but rather is disproportionately borne by nursing homes that have no Medicaid residents (like Albany Avenue) and those that have the lowest Medicaid occupancy rates.

The opinion below applied the most deferential level of scrutiny to New York's scheme, as if the political process were functioning normally. But linking the assessment with the reimbursement as an inseparable package subverted the normal political process and allowed the Legislature to avoid the full political consequences of its actions. The overwhelming majority of nursing homes that might have opposed the imposition of an assessment on their revenues if the proceeds were to become part of the State's general revenue were "bought off" by receiving back the amount of the assessment that was imposed on their Medicaid revenues. The effect was to isolate politically marginal taxpayers, such as Petitioners, and sacrifice them in order that the Legislature could exploit the federal subsidy.

This Court's jurisprudence, however, does not allow a small group to be sacrificed for the good of the majority unless there is full political accountability. "[N]othing opens the door to arbitrary action so effectively as to allow . . . officials to pick and choose only a few to whom they will apply legislation and thus to escape the political retribution that might be visited upon them if larger numbers were affected." *Railway Express Agency, Inc. v. N.Y.*, 336 U.S. 106, 112-13 (1949). "[L]egislation which restricts those political processes which can ordinarily be expected to bring

about repeal of undesirable legislation, [may] be subjected to more exacting judicial scrutiny under the general prohibitions of the Fourteenth Amendment than are most other types of legislation." *Kovacs v. No. 9*, 336 U.S. 77, 92, n.1 (1949).

By adopting the most deferential standard of review, the court below viewed the New York legislation as if the assessments were first paid into general revenue, and then, as if through the normal budgetary processes, the Legislature made a decision to return the assessments to the nursing homes in an amount equal to what they paid on their Medicaid revenues. However, as this Court has recently recognized in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), from a political perspective there is a fundamental difference between an assessment that is paid into general revenue and an assessment that is earmarked for a particular group of beneficiaries. In the former, the political process is working as intended; in the latter, the process has been subverted.

West Lynn involved the constitutionality of a Massachusetts tax and spending program, which was similar to New York's tax and spending program at issue in this case. Massachusetts adopted a "milk pricing order," essentially a tax, which applied to all milk sold to Massachusetts retailers. The proceeds from the tax were earmarked for, and distributed to, Massachusetts dairy farmers.

Similar to the way the court below analyzed the New York scheme, Massachusetts argued that the tax and spending program should be evaluated as if the tax component were independent from the spending component. Analyzed from

this perspective, the tax would appear unexceptional because it was a uniform and nondiscriminatory levy on milk; the subsidy would also appear unexceptional as part of the State's normal budgetary process. The court below adopted this perspective in analyzing the New York scheme: A uniform and nondiscriminatory tax on nursing homes and an increase in Medicaid reimbursement rates.

This view, however, is defective because it ignores the political reality that the tax and spending components were not independent, but rather were interdependent. This Court looked through the formal nature of the State's analysis in *West Lynn* and concluded that the State's

> argument would require us to analyze separately two parts of an integrated regulation, but we cannot divorce the premium payments from the use to which the payments are put. It is the entire program — not just the contributions to the fund or the distributions from that fund — that simultaneously burdens interstate commerce and discriminates in favor of local producers. The choice of constitutional means — nondiscriminatory tax and local subsidy — cannot guarantee the constitutionality of the program as a whole.

West Lynn Creamery, Inc., 512 U.S. at 201.

Although *West Lynn* involved a commerce clause challenge, the logic and reasoning of the Court applies with equal force to determining the proper level of analysis under the equal protection clause. *See, e.g.*, John Hart Ely, Democracy and Distrust: A Theory of Judicial Review, chs.

4-5 (1980). The discrimination that characterized the Massachusetts tax and spending program struck down in *West Lynn* shares the same evil as the New York tax and spending program. By tying together the tax and the spending program in an interdependent package, the legislatures in each case were able to "buy out opposition" to the tax, bypass the usual checks and balances that should govern tax legislation, subvert the functioning of representative government by interfering with the normal functioning of political coalitions, and corrupt the normal anti-majoritarian safeguards.

As this Court recognized in *West Lynn*:

> More fundamentally, [the State] errs in assuming that the constitutionality of the pricing order follows logically from the constitutionality of its component parts. By conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone. Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse." However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by subsidy. So, in this case, one would ordinarily have expected at least three groups to lobby against the order premium, which, as a tax, raises

> the price (and hence lowers demand) for milk: dairy farmers, milk dealers, and consumers. But because the tax was coupled with a subsidy, one of the most powerful of these groups, Massachusetts dairy farmers, instead of exerting their influence against the tax, were in fact its primary supporters.

512 U.S. 186, 199-201 (citations omitted).

The parallels with the New York scheme are striking. Both Massachusetts and New York were facing contentious political problems. Either state could have attempted to increase taxes, but there would have been serious political opposition — in the former, from dairy farmers and milk dealers; in the latter, from nursing homes. But by tying the tax and spending components, the political opposition was mollified — dairy farmers were bought off in Massachusetts and the majority of nursing homes were bought off in New York. If anything, the New York situation presents an even stronger case for heightened judicial scrutiny because in Massachusetts there were at least two groups of likely opponents to the tax who were not appeased — consumers and dealers. In New York, consumers of Medicaid services were also beneficiaries of the tax and reimbursement scheme, leaving only a minority of nursing homes to oppose the legislation. Compared to Massachusetts, the New York legislation provided an even greater threat to the normal functioning of the political process.

The Court's analysis in *West Lynn* should not be limited to Commerce Clause cases. Indeed, every commerce clause challenge to a statute could be rephrased as an equal protection argument with in-state commerce constituting one

class and out-of-state commerce constituting the other. *See* Pomp and Oldman, State and Local Taxation 2-1 (3d ed. rev. 2000). More generally, the philosophy embodied in the Court's *West Lynn* analysis informs other Constitutional safeguards, such as Article Four's Privileges and Immunities Clause, and the Fifth Amendment's "just compensation" clause. Similar to the values protected in *West Lynn*, both of these provisions protect "outsiders" against the actions of "insiders." In the case of the Privileges and Immunities Clause, nonresidents (the outsiders) are protected against the actions of residents (the insiders). The just compensation provision protects an individual (the outsider) from bearing the cost of being forced to give up his or her property for the good of others (the insiders). Consequently, the issues raised by the Petitioners transcend the Equal Protection Clause and go to the very essence of representative government.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for certiorari.

Respectfully submitted,

RICHARD HAMBURGER
Counsel of Record
HAMBURGER, MAXSON
& YAFFE, LLP
225 Broadhollow Road
Suite 404W
Melville, NY 11747
(631) 694-2400

RICHARD D. POMP
Visiting Professor of Law
Harvard Law School
Areeda 126
Cambridge, MA 02138
(617) 496-8685

Attorneys for Petitioners

Of Counsel:

RICHARD HAMBURGER
LANE T. MAXSON
RICHARD D. POMP
DAVID N. YAFFE

APPENDIX

APPENDIX A — OPINION AND ORDER OF THE COURT OF APPEALS FOR THE STATE OF NEW YORK DATED AND DECIDED DECEMBER 16, 1999

STATE OF NEW YORK
COURT OF APPEALS

2 No. 184

Port Jefferson Health Care Facility, et al.,

Respondents,

v.

Brian Wing, &c., et al.,

Appellants.

OPINION

* * *

LEVINE, J.

Plaintiffs are 21 for-profit residential health care facilities (RHCFs) located in various parts of the State. They have brought this suit challenging the constitutional validity of assessments of 1.2% and 3.8% on RHCF gross receipts under a statutory scheme whereby those taxes on receipts for the care of Medicaid patients are reimbursed as a recoverable expense of care.

The State first assessed a tax on the gross receipts of RHCFs for the period January 1, 1991 to March 31, 1992, at

the rate of .6%, with no reimbursement (L 1990, ch 938, § 28). The statute creating the assessment specifically provided that the tax was not a recoverable Medicaid expense (*see*, Public Health Law § 2807-d[10][a]). Thus, in the original RHCF gross receipts legislation, the burden of the tax was imposed uniformly on all of the gross receipts of all RHCFs, regardless of source.[1] The .6% original assessment is not at issue on this appeal.

In 1992, the Legislature extended the original .6% assessment and imposed an "additional assessment" of 1.2% (L 1992, ch 41, § 5; Public Health Law § 2807-d[2][b][ii]). That enactment provided, however, that, contingent upon all Federal approvals necessary for Federal financial participation in the State's Medicaid program, the additional 1.2% assessment as applied to RHCF Medicaid receipts would be a reimbursable cost of care (*id.*, § 11; Public Health Law § 2807-d[10][b]). In 1995, the Legislature enacted a "further additional assessment" of 3.8% on RHCF gross receipts, and again provided that, contingent upon Federal approvals, that tax paid on Medicaid receipts would be a reimbursable expense (L 1995, ch 2, § 136; Public Health Law § 2807-d[2][b][iii]).[2]

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1. Certain nonprofit, private proprietary general hospitals and facilities dedicated solely for the care of police, firefighters and emergency services personnel were not charged the assessments (*see*, Public Health Law § 2807-d[1][b]). Those exemptions are not at issue on this appeal.

2. Congress, in section 4722(c) of the Balanced Budget Act of 1997 (Pub L 105-33), approved both additional assessments as permissible health care related taxes. Thus, the contingencies for State reimbursement of both additional assessments on Medicaid receipts were met.

Plaintiffs brought this action in 1995, seeking declaratory and injunctive relief, and a refund of gross receipt taxes paid.[3] On this appeal, they rely entirely on the claim that their Fourteenth Amendment rights to equal protection of the law have been violated by the statutory scheme in which the State imposes a 1.2% and 3.8% gross receipts tax upon all of the receipts of all RHCFs, but only reimburses RHCFs for taxes paid on receipts for the care of Medicaid patients. They assert that this statutory scheme unconstitutionally discriminates against RHCFs whose non-Medicaid patient population (i.e., private pay patients and patients whose nursing home fees are funded by insurers, health maintenance organizations or the Federal Veterans Administration) is larger than the Statewide average of 20%.

On plaintiffs' motion for summary judgment, they submitted evidence to demonstrate that (1) while private pay rates substantially exceed allowable Medicaid rates, an RHCF's net profits do not correlate with having a higher percentage of private pay residents in its patient population; and (2) RHCFs catering largely to Medicaid patients are able to earn substantial profits under existing Medicaid reimbursement rates.

Supreme Court granted plaintiffs' motion. It concluded that, as a gross receipts tax, the statutory scheme imposed the burden of the assessments more heavily upon some

3. The Legislature has since phased out the original .6% assessment on RHCF gross receipts and the additional assessment of 1.2% (L 1997, ch 389, §§ 196-197). The further additional assessment of 3.8% is scheduled to expire January 1, 2000 (L 1999, ch 407, pt CC, § 4).

RHCFs than others, without any policy justification other than the State's interest in raising revenue, which it considered to be inadequate (*citing*, *Stewart Dry Goods Co. v. Lewis*, 294 US 550). The court further held that plaintiffs' evidence dispelled all of the rationales suggested by the State for the differential treatment of RHCFs based on their relative mix of Medicaid and non-Medicaid patients.

On the State's appeal, the Appellate Division affirmed (253 AD2d 548). The court determined that there was a disparity of taxation under the assessment and Medicaid reimbursement scheme, as RHCFs with larger Medicaid populations "have the majority of their revenues not subject to assessments * * *, while RHCFs like plaintiffs, having a large proportion of gross receipts from non-Medicaid sources, must shoulder the burden" (*id.*, at 549-550). That court further held that a denial of equal protection occurred here because of that disparate treatment, which could not be justified by the State's interest in raising revenue (*id.*, at 550). The Appellate Division also held that a gross receipts tax treating "differently the same transactions — the provision of skilled care to residents of RHCFs — without regard to profits (*id.*)," was invalid under *Stewart Dry Goods Co. v Lewis* (*supra*).

On the State's appeal as of right (CPLR 5601[d]), we reverse and declare the statutory scheme constitutional.

Discussion

The parties do not dispute that these gross receipts taxes do not proceed along suspect lines or involve any

fundamental rights of plaintiffs. Therefore, there are three well-established principles that set the framework for equal protection review on this appeal. First, any classification respecting differential taxation of nursing homes, in this case based on the composition of their patient populations, enjoys a strong presumption of constitutionality, which plaintiffs must overcome beyond a reasonable doubt (*see*, *Maresca v Cuomo*, 64 NY2d 242, 250). Second, the assessments are subject to the lowest level of judicial review, whether any rational basis supports the legislative choices (*see*, *id.*; *see also*, *Heller v Doe*, 509 US 312, 319-320).

Third, here rational basis review is being applied to a system of taxation. "This standard is especially deferential in the context of classifications made by complex tax laws" (*Nordlinger v Hahn*, 505 US 1, 11). We noted in *Trump v Chu* (65 NY2d 20) that, in reviewing the validity of taxation classifications "the equal protection clause does not prevent State Legislatures from drawing lines that treat one class of individuals or entities differently from others unless the difference in treatment is 'palpably arbitrary' or amounts to an 'invidious discrimination' " (*id.*, at 25 [citing, *inter alia*, *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 US 356, 360]). The Equal Protection Clause "imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of State taxation. The State may impose *different specific taxes upon different trades and professions and may vary the rate of excise upon various products*" (*Allied Stores of Ohio, Inc v. Bowers*, 358 US 522, 526-527 [emphasis supplied]).

In our view, plaintiffs have failed to meet their heavy burden of demonstrating a violation of the Equal Protection Clause here. We assume without deciding that this taxing scheme — which at most has the net effect of exempting RHCF receipts for the care of Medicaid patients from a general gross receipts tax on all of these facilities — created a "discrete and objectively identifiable class" triggering equal protection analysis in the first instance (*San Antonio Independent School Dist. v Rodriguez*, 411 US 1, 22; *id.*, at 60 [Stewart, J., concurring]). Even if the classifications in these gross receipts assessment statutes created a discrete class of nursing homes taxed disparately on the basis of their low proportions of medically indigent patients, plaintiffs have failed to establish any equal protection violation under the rational basis level of judicial scrutiny applicable here, and the courts below erred by holding otherwise. That standard of review has been characterized by the United States Supreme Court as "a paradigm of judicial restraint" (*Federal Communications Commn. v Beach*, 508 US 307, 314).

Under the rational basis standard, the Legislature, in creating a classification, "need not actually articulate at any time the purpose or rationale supporting its classification. Instead, a classification must be upheld against an equal protection challenge if there is any *reasonably conceivable* state of facts that could provide a rational basis for the classification" (*Heller v Doe, supra*, 509 US, at 320 [internal citations and quotation marks omitted] [emphasis supplied]).

Two principles flow from the proposition that any *reasonably conceivable* state of facts provides a sufficient

rational basis to sustain a classification. First, "it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature" (*Federal Communications Commn. v Beach*, *supra*, at 315). Thus, "[t]he legitimate purpose justifying the provision *need not be the primary purpose* of the provision * * * and, indeed, a court may even *hypothesize* the motivations of the State Legislature to discern any conceivable legitimate objective promoted by the provision under attack" (*Maresca v Cuomo*, *supra*, 64 NY2d, at 251 [emphasis supplied]). Second, the State "has no obligation to produce evidence to sustain the rationality of a statutory classification. A legislative choice is *not subject to courtroom factfinding* and may be based on *rational speculation* unsupported by evidence or empirical data" (*Heller v Doe*, *supra*, at 320 [internal quotation marks omitted] [emphasis supplied]).

The United States Supreme Court's rejection of the equal protection challenge to California's Proposition 13 in *Nordlinger v Hahn* (*supra*) is especially instructive here. Under Proposition 13, approved by the California voters in 1978, increases in residential and commercial real property tax assessments were limited to 2% a year, with exceptions only for new construction or a change in ownership (other than from parent to child). This essentially created an "acquisition-value system" (*id.*, at 6) of property assessment, in which only assessments on recently acquired properties reflected current market values. As the Court in *Nordlinger* noted, because of the dramatic inflation in California real estate values after 1978, this " 'welcome stranger' " system, resulted, by 1989, in "staggering" disparities in tax burdens

in which, overall, "the 44% of California homeowners who have owned their homes [ever] since the enactment of Proposition 13 in 1978 shouldered only 25% of the more than $4 billion in residential property taxes paid by homeowners statewide" (*id.*).

Indeed, the petitioner in *Nordlinger*, who bought a relatively modest home in 1988, paid "about five times more in taxes than some of her neighbors who owned comparable homes since 1975 within the same residential development * * * [and] only a few dollars short of that paid by a pre-1976 owner of a $2.1 million Malibu beachfront home" (*id.*, at 7). Moreover, as noted in Justice Stevens' dissent, the disparities in tax burdens were further exacerbated under Proposition 13 by the exemption, available "repeatedly and indefinitely," from change-in-ownership reassessment for transfers from parent to child (*id.*, at 29). Thus, "[t]wo families with equal needs and equal resources are treated differently solely because of their different heritage" (*id.*, at 30).

Nonetheless, the Supreme Court upheld California's Proposition 13 against the equal protection challenge. The Court first noted that the rational basis standard of review "is especially deferential" with respect to tax law classifications (*id.*, at 11). Without referring to any legislative history actually leading to the approval of Proposition 13 by California voters, the Court posited two conceivable rationales for sustaining it: (1) a State interest in fostering "local neighborhood preservation, continuity, and stability" which Proposition 13 arguably furthered in its tendency "to discourage rapid turnover in ownership of homes and businesses" (*id.*, at 12); and (2) differences in "reliance

interest" between new homeowners and existing homeowners regarding precipitous real property tax increases (*id.*, at 12-13). The Court held that the exemption from reassessment for transfers from parent to child could be sustained as furthering "the interests of family and neighborhood continuity and stability" (*id.*, at 17).

Nordlinger, in our view, is controlling here. First, plaintiffs as a class have not established disparities in tax burdens anywhere approaching the "staggering" inequalities demonstrated in *Nordlinger*. Second, here the Legislature had concrete facts upon which reasonably to conclude that an RHCF gross receipts tax should be structured to: (1) reduce the incentive for higher quality-of-care RHCFs to prefer admitting patients who could finance their care from their own resources rather than Medicaid patients; and (2) encourage those RHCFs to share in the burden of providing skilled nursing home care for the medically indigent. The record reveals that daily rates charged private patients in RHCFs may exceed Medicaid rates at the same facilities by as much as 65%. Moreover, the State restricts the expansion of available RHCF beds (*see*, Public Health Law § 2802[2]; *Baird v. Axelrod*, 102 AD2d 972, *affd for reasons stated below* 65 NY2d 655). Therefore, in any given RHCF, a powerful economic incentive exists for preferring non-Medicaid patients for existing beds.

The Legislature has expressly identified the provision of equality of medical care for the needy through the Medicaid system as a matter of public concern (*see*, Social Services Law § 363). Furthermore, a tax exemption for receipts from the care of Medicaid patients far more directly

relates to and furthers the State's interest in securing equality of nursing home care for the indigent, than does the acquisition-value assessment system of California's Proposition 13 relate to a State interest in family and neighborhood stability, found sufficient in *Nordlinger v Hahn*. Thus, in our view, the RHCF gross receipts tax scheme here readily passes rational basis review.

Plaintiffs' arguments to the contrary are unavailing. They urge that, in identifying a legitimate State interest affording a rational basis for the claimed disparities in taxation among RHCFs, the State should be limited to the objectives of revenue-raising, and Medicaid cost-shifting and cost-cutting, referred to in the legislative history. Nothing whatsoever in the legislative history, however, demonstrates that those objectives were exclusive. Moreover, plaintiffs' position directly conflicts with settled equal protection jurisprudence that any *reasonably conceivable* legitimate State interest suffices (*Heller v Doe, supra*, at 320) and that the relevant State interests need *not* have been the *primary* legislative objective (*Maresca v Cuomo, supra*, at 251).[4]

4. In urging that encouraging RHCFs to share the burden of Medicaid patients is not a relevant legitimate State interest here, plaintiffs also heavily rely on a 1995 Medicaid reform bill (L 1995, ch 81) which is entirely unrelated to the RHCF gross receipts tax under review. Section 64 of that law (as amended by L 1996, ch 474, § 204) provided for financial penalties (of Medicaid reimbursement) to facilities failing to increase their Federally-funded Medicare utilization. Plaintiffs draw the conclusion that this provision is designed to reduce service of the State's Medicaid population by RHCFs and thus is at cross-purposes with the State interest recognized here. Plaintiffs' conclusion is unwarranted. (Cont'd)

In any event, plaintiffs' argument from legislative purposes only proves the obvious: that, indeed, the challenged statutory provisions, essentially providing an exemption for Medicaid receipts from the RHCF gross receipts taxes, did *not* further the Legislature's cost containment or revenue raising objective. The appropriate conclusion from that unremarkable and undebatable fact is not that the exemption is unconstitutional, but merely that the Legislature had other purposes in mind in enacting the exemption, including, conceivably, the ones we have identified; that is, to mitigate the disincentive of higher quality-of-care RHCFs from admitting Medicaid patients and to encourage those nursing homes to share in the burden of caring for the medically needy.

Plaintiffs also heavily rely on the evidence they submitted showing that efficiently and economically operated RHCFs catering to a Medicaid clientele can earn substantial profits at Medicaid reimbursement rates and may even be more profitable than some facilities predominantly caring for non-Medicaid patients. That evidence might have some relevancy had ability to pay been the rationale advanced

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(Cont'd)
Medicare funding for skilled nursing home care is generally temporary, for not more than the first 100 days following admission to the facility (*see*, 42 USC § 1395d[a][2][A]). There is nothing to indicate that once Medicare funding runs out, formerly Medicare-eligible patients in RHCFs are less likely to require Medicaid funding thereafter than the general percentages of Medicaid patients in RHCFs Statewide. Thus, the State's interest in promoting the admission of such patients to high quality nursing homes remains the same, and, no cross-purposes exist.

by the State for any tax burden disparities among RHCFs here. It has little if any bearing, however, on the rationality of a classification created to provide individual RHCFs with an incentive, given their existing staff/patient ratios and other profit-determinative factors, to accept a greater share of the burden of care for the indigent. In any event, plaintiffs' effort to induce this Court to utilize evidentiary facts to counteract arguable legislative assumptions violates the rule that a legislative choice is not subject to courtroom factfinding (*Heller v Doe*, *supra*, at 320).

Finally, the reliance of plaintiffs and the courts below on the 1935 case of *Stewart Dry Goods Co. v Lewis* (*supra*) to establish an equal protection violation is misplaced. In *Stewart Dry Goods Co.*, the Supreme Court, with Justices Brandeis, Stone and Cardozo in dissent, struck Kentucky's graduated gross receipts tax on *all* retail sales as a violation of the Equal Protection Clause. In *Stewart Dry Goods Co.*, Kentucky taxed the gross receipts from the sale of the *very same* items at different rates, depending upon the volume of such sales by any particular merchant. As we pointed out in *Trump v Chu* (*supra*), in *Stewart Dry Goods Co.* "[t]he *only conceivable justification* for this different treatment was that a merchant's net income and consequently his ability to pay the tax increased as his volume of sales increased" (*id.*, 65 NY2d, at 26 [emphasis supplied]). The Supreme Court invalidated the graduated gross receipts tax in *Stewart Dry Goods Co.* because of the undeniable fact that sales volume is *not* a reliable indicator of a merchant's profits, i.e., ability to pay (*see*, *Trump v Chu*, *supra*, at 26). Here, the tax on gross receipts is at a flat rate (*see*, *New York Rapid Tr. Corp. v City of New York*, 303 US 573) and, as we have

demonstrated above, for legitimate reasons entirely unrelated to ability to pay, the State has rationally chosen to treat receipts from the "sale" to the State of nursing home care for the medically indigent differently from receipts from the sale of such services paid for by private or commercial sources.

Accordingly, the judgment of Supreme Court appealed from and the order of the Appellate Division brought up for review should be reversed, with costs, and judgment granted declaring Public Health Law §§ 2807-d(2)(b)(ii) and (iii) and 2807-d(10)(b) constitutional.

Judgment appealed from and order of the Appellate Division brought up for review reversed, with costs, and judgment granted declaring Public Health Law §§ 2807-d(2)(b)(ii) and (iii) and 2807-d(10)(b) constitutional. Opinion by Judge Levine. Chief Judge Kaye and Judges Bellacosa, Smith, Ciparick, Wesley and Rosenblatt concur.

Decided December 16, 1999

Appendix A

Remittitur

COURT OF APPEALS
STATE OF NEW YORK

The Hon. Judith S. Kaye, Chief Judge, Presiding

2 No. 184

Port Jefferson Health Care Facility, et al.,

Respondents,

v.

Brian Wing, &c., et al.,

Appellants.

The appellants in the above entitled appeal appeared by Hon. Eliot Spitzer, Attorney General of the State of New York; the respondents appeared by Hamburger Maxson & Yaffe, LLP.

The Court, after due deliberation, orders and adjudges that the judgment appealed from and order of the Appellate Division brought up for review are reversed, with costs, and judgment granted declaring Public Health Law §§ 2807-d(2)(b)(ii) and (iii) and 2807-d(10)(b) constitutional. Opinion by Judge Levine. Chief Judge Kaye and Judges Bellacosa, Smith, Ciparick Wesley and Rosenblatt concur.

Appendix A

The Court further orders that this record of the proceedings in this Court be remitted to the Supreme Court, Suffolk County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

s/ Stuart M. Cohen
Stuart M. Cohen,
Clerk of the Court

Court of Appeals, Clerk's Office, Albany, December 16, 1999

APPENDIX B — ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK DATED AND FILED JANUARY 26, 1999

At an I.A.S. Term, Part 8 of the Supreme Court of the State of New York, held in the Courthouse, located at 235 Griffing Avenue, Riverhead, New York 11901 on the 26th day of January, 1999.

PRESENT:

HON. JAMES M. CATTERSON, J.S.C.

Index No. 95-23917

PORT JEFFERSON HEALTH CARE FACILITY, BIRCHWOOD HEALTH CENTER, CARILLON HOUSE NURSING FACILITY, LITTLE FLOWER NURSING HOME, NESCONSET NURSING CENTER, PATCHOGUE NURSING CENTER, PETITE FLEUR NURSING HOME, RIVERHEAD NURSING HOME, ST. JAMES NURSING HOME, ST. JAMES PLAZA NURSING FACILITY, SUNREST HEALTH FACILITIES, INC., CENTRAL ISLAND HEALTH CARE, GLENGARIFF HEALTH CARE CENTER, GRACE PLAZA OF GREAT NECK, INC., SOUTH SHORE HEALTHCARE, SUNHARBOR MANOR, WOODBURY NURSING HOME, PORT CHESTER NURSING HOME, MAPLEWOOD NURSING HOME, MEADOWBROOK NURSING HOME and ALBANY AVENUE NURSING HOME,

Plaintiffs,

– against –

Appendix B

BRIAN J. WING, as Acting Commissioner of Social Services of the State of New York, BARBARA ANN DeBUONO, M.D., M.P.H., as Commissioner of Health of the State of New York, and the STATE OF NEW YORK,

Defendants.

ORDER

UPON, the Decision and Order (one paper) of the Appellate Division, Second Department, entered August 31, 1998; and

UPON, the Affirmation in Support of Proposed Order of Richard Hamburger, dated November 30, 1998; and

UPON, all the prior pleadings and proceedings heretofore had herein, it is hereby,

ORDERED, that defendants are directed to reimburse the plaintiff Port Jefferson Health Care Facility all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after August 11, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Birchwood Health Center all monies it paid as an "additional assessment" pursuant to Public Health Law

§ 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Carillon House Nursing Facility all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after September 11, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Little Flower Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after September 13, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Nesconset Nursing Center all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after

October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Patchogue Nursing Center all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Petite Fleur Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after September 13, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Riverhead Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously

reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff St. James Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after December 8, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff St. James Plaza Nursing Facility all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after November 14, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Sunrest Health Facilities, Inc. all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after November 14, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

Appendix B

ORDERED, that defendants are directed to reimburse the plaintiff Central Island Health Care all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Glengariff Health Care Center all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after August 11, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Grace Plaza of Great Neck, Inc. all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff South Shore Healthcare all monies it paid as an

"additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Sunharbor Manor all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after September 11, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Woodbury Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after November 9, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Port Chester Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment"

pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after August 14, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Maplewood Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after August 9, 1998, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Meadowbrook Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after October 6, 1995, plus interest at nine percent per annum from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that defendants are directed to reimburse the plaintiff Albany Avenue Nursing Home all monies it paid as an "additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(ii) and as a "further additional assessment" pursuant to Public Health Law § 2807-d(2)(b)(iii), on or after September 13, 1995, plus interest at nine percent per annum

from the date of each payment, less any such monies previously reimbursed as a "reimbursable cost" pursuant to Public Health Law § 2807-d(10); and it is further

ORDERED, that with respect to "reimbursable cost" reimbursements made pursuant to Public Health Law § 2807-d(10), each such reimbursement to each facility shall be credited as of the date of such reimbursement; and it is further

ORDERED, that plaintiffs' are awarded attorneys' fees and costs, in the sum of $128,043.26, pursuant to 42 U.S.C. § 1988, through and including November 30, 1998.

ENTER,

s/ JAMES M. CATTERSON
JAMES M. CATTERSON, J.S.C.

APPENDIX C — DECISION AND ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK, APPELLATE DIVISION, SECOND JUDICIAL DEPARTMENT DATED AUGUST 31, 1998

SUPREME COURT OF THE STATE OF NEW YORK APPELLATE DIVISION : SECOND JUDICIAL DEPARTMENT

__ AD2d __ Argued – June 12, 1998

SONDRA MILLER, J.P.
GABRIEL M. KRAUSMAN
LEO F. McGINITY
DANIEL F. LUCIANO, JJ.

97-08519

Port Jefferson Health Care Facility, et al.,

respondents,

v

Brian Wing, etc., et al.,

appellants.

DECISION & ORDER

* * *

In an action for declaratory and injunctive relief, the defendants appeal, as limited by their brief, from so much

an order of the Supreme Court, Suffolk County (Newmark, J.), entered August 27, 1997, as granted that branch of the plaintiffs' motion which was for summary judgment as to the second cause of action of their amended complaint, and as declared that a 1.2% additional assessment and a 3.8% further additional assessment on gross receipts of residential health care facilities, pursuant to Public Health Law § 2807-d(2)(b)(ii) and (iii), violated the plaintiffs' equal protection rights.

ORDERED that the order is affirmed insofar as appealed from, with costs.

In 1990, in response to a Medicaid program deficit, the Legislature enacted Public Health Law § 2807-d, which imposed an assessment on residential health care facilities (hereinafter RHCFs), requiring them to pay a percentage (fixed at 0.6%) of gross receipts from all patient care services and operating income for a 15-month period (Public Health Law § 2807-d[1][a]; L 1990, ch 938, § 28). In 1992, the statute was amended, eliminating the March 31, 1992, sunset date for the 0.6% assessment and imposing an additional assessment of 1.2%, over and above the initial 0.6% assessment (*see*, L 1992, ch 41, §§ 5, 54, 163). The 1992 amendment also included another feature: the additional assessment of 1.2% was declared a reimbursable cost in determining the facility's Medicaid rate (*see*, Public Health Law § 2807-d[10][b]; L 1992, ch 41, § 11).

In 1995 and 1996, the Legislature again amended the statute to impose additional assessments on RHCFs, notably, an additional 3.8% for the period July 1, 1995, to March 31,

1996 (*see*, L 1995, ch 2, § 136; Public Health Law § 2807-d[2][b][iii]). As with the earlier 1.2% assessment, the statute was amended to provide that the further additional assessment of 3.8% was a reimbursable cost in determining a facility's Medicaid rate (*see*, L 1995, ch 2, § 139; Public Health Law § 2807-d[10][b]).

The plaintiffs, 21 private RHCFs located in various counties throughout New York State who care for substantial proportions of non-Medicaid residents and who receive large proportions of revenue from non-Medicaid sources, commenced the instant action for declaratory and injunctive relief, challenging the constitutionality of the additional assessment of 1.2% and the further additional assessment of 3.8% on the gross receipts received by RHCFs, which were imposed by Public Health Law § 2807-d, as amended in 1992 and 1995 (*see*, Public Health Law § 2807-d[2][b][ii], [iii]). The Supreme Court, *inter alia*, declared that the 1.2% and the 3.8% assessments on the gross receipts of RHCFs, imposed pursuant to Public Health Law § 2807-d, were unconstitutional as violative of the plaintiffs' rights to equal protection. We affirm.

As this court has stated, "[a] tax or assessment will rarely fall with exquisite perfection and equality on all who are slated to pay" (*Miriam Osborn Mem. Home Assn. v. Chassin*, 240 AD2d 143, 149). "To meet equal protection criteria, however, there must be general uniformity of treatment of those similarly situated, the classifications for disparity must be reasonable, and the taxes imposed must be uniform within the class" (*Miriam Osborn Mem. Home Assn. v. Chassin*, *supra*, at 149; *Foss v. City of Rochester*, 65 NY2d 247; *Trump*

v. Chu, 65 NY2d 20; *see also*, *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 US 356; *Allied Stores of Ohio v. Bowers*, 358 US 522). The challenged assessments are not uniformly imposed and do disparately impact taxed RHCFs, despite the fact that all are engaged in the same activity and, by Federal regulations, are required to provide the same quality of care (*see*, 42 CFR 483.12[7][c][1]). The greater the proportion of Medicaid services provided by an RHCF, the greater the proportion of that particular RHCF's gross receipts assessments would be reimbursed by the State. Thus, those facilities having a large Medicaid population have the majority of their revenues not subject to assessments (beyond the initial assessment of 0.6%), while RHCFs like the plaintiffs, having a large proportion of gross receipts from non-Medicaid sources, must shoulder the burden of the assessments (at the effective rate of 5.6%). The disparate treatment of similarly-situated RHCFS is based solely on the source from which the revenue was received.

This classification, though discriminatory, would not violate the principles of due process or equal protection if it was "founded upon a reasonable distinction, or difference in state policy" (*Allied Stores of Ohio v. Bowers*, *supra*, at 528; *see also*, *Trump v. Chu*, *supra*; *Foss v. City of Rochester*, *supra*). The only argument advanced by the defendants for the distinction, which is worthy of note, is the State's interest in raising revenue. However, by providing for reimbursement of the 1.2% and 3.8% assessments based upon the extent of a facility's Medicaid population, the State is acting at odds with its efforts to reduce Medicaid costs.

Appendix C

Moreover, the statutes challenged herein impermissibly impose gross receipts taxes which treat differently the same transaction — the provision of skilled care to residents of RHCFs — without regard to profits (*see*, *Stewart Dry Goods Co. v. Lewis*, 294 US 550; *Trump v. Chu*, *supra*, at 26).

Accordingly, the 1.2 percent and 3.8 assessments challenged herein are unconstitutional as violative of the plaintiffs' equal protection rights.

MILLER, J.P., KRAUSMAN, McGINITY and LUCIANO, JJ., concur.

ENTER:

Martin H. Brownstein
Clerk

APPENDIX D — MEMORANDUM OF THE SUPREME COURT OF NEW YORK, SUFFOLK COUNTY DATED JUNE 30, 1997

SUPREME COURT, SUFFOLK COUNTY

I.A.S. PART 8

BY: NEWMARK, L.

DATED: June 30, 1997

Mot. Seq. # 001 – MG; 002 – XMD

INDEX #: 95-23917

PORT JEFFERSON HEALTH CARE FACILITY, BIRCHWOOD HEALTH CENTER, CARILLON HOUSE NURSING FACILITY, NESCONSET NURSING CENTER, PATCHOGUE NURSING CENTER, PETITE FLEUR NURSING HOME, ST. JAMES NURSING HOME, ST. JAMES PLAZA NURSING FACILITY, SUNREST HEALTH FACILITIES, INC., RIVERHEAD NURSING HOME, CENTRAL ISLAND HEALTH CARE, GLENGARIFF HEALTH CARE CENTER, GRACE PLAZA OF GREAT NECK, INC., SOUTH SHORE HEALTHCARE, SUNHARBOR MANOR, WOODBURY NURSING HOME, PORT CHESTER NURSING HOME, MAPLEWOOD NURSING HOME, MEADOWBROOK NURSING HOME and ALBANY AVENUE NURSING HOME,

Plaintiffs,

– against –

Appendix D

BRIAN J. WING, as Acting Commissioner of Social Services of the State of New York, BARBARA ANN DeBUONO, M.D., M.P.H., as Commissioner of Health of the State of New York, and the STATE OF NEW YORK,

Defendants.

MEMORANDUM

* * *

The plaintiffs are private Residential Health Care Facilities (RHCFs) located in various counties throughout New York State, established pursuant to provisions of Public Health Law Article 28. They provide skilled nursing care to patients who occupy their facilities, and all but one, Albany Avenue Nursing Home, receive income for the care provided to their residents from a variety of sources, including residents' private funds, insurance policies, Medicare and Medicaid. In this action for declaratory and injunctive relief, they challenge the constitutionality of certain tax assessments imposed upon them by the New York State Legislature. They contend that despite the fact that "all members of the class of RHCFs subjected to these assessments are involved in the same activity — the provision of care to nursing home residents — the tax assessed upon income earned from this activity is not imposed uniformly and violates their rights to equal protection of the laws under the Federal and State Constitutions."

Plaintiffs have moved for summary judgment declaring the assessments unconstitutional as violative of their equal

protection rights, permanently enjoining defendants from collecting the assessments, directing defendants to refund all amounts which they have paid "under protest," and awarding them attorneys' fees pursuant to 42 U.S.C. § 1988. Defendants cross-move pursuant to CPLR 3212 for dismissal of the second and eleventh causes of action of the amended complaint in which the above claims are asserted and for a hearing on the attorneys' fees incurred in opposing the action.

BACKGROUND

Since the inception of the Medicaid program in 1966, the method for reimbursing facilities such as plaintiffs has undergone significant change. Prior to 1981, the federal statute required reimbursement of the "reasonable cost" of health services rendered to Medicaid patients. This retrospective method reimbursed facilities based upon their actual, allowable costs. The "reasonable cost" standard came to be regarded as "inherently inflationary and contain[ing] no incentive for efficient performance" (*see*, ***Colorado Health Care Association v Colorado Department of Social Services***, 842 F.2d 1158, 1165, n.6 [10th Cir. 1988]) and was repealed by Congress as part of the Omnibus Budget Reconciliation Act of 1980 (the "Boren Amendment").

The Boren Amendment had two purposes: i) to give the states flexibility in setting their reimbursement rates without requiring them to follow complex procedures of review and approval by the federal government; and ii) to reduce the cost of the Medicaid program by allowing states to develop simpler methods of payment that would promote the efficient and economical delivery of health services (***Colorado Heal Care Assn. v DSS***, *supra*; ***Pinnacle Nursing Home v***

Axelrod, 719 F.Supp. 1173, 1176 [W.D.N.Y. 1989]). Hence the amendment required each participating state to find and make assurances satisfactory to the Secretary of the Department of Health and Human Services that the Medicaid rate set by the state for nursing homes is "reasonable and adequate to meet the costs which must be incurred by efficiently and economically operated facilities (EEOFs) in order to provide care and services in conformity with applicable state and federal . . . standards." Apparently, once a state's "assurances" are accepted and approved, there is no further federal oversight unless a state makes a "significant change" in its payment method or standard (*see*, ***Pinnacle Nursing Home v Axelrod***, *supra*, 719 F.Supp. at 1177).

Pursuant to Public Health Law Article 28, the New York State Department of Health is charged with the responsibility of setting Medicaid reimbursement rates for RHCFs such as plaintiffs. From 1986 until 1995, New York has set its Medicaid reimbursement rate prospectively, based upon 1983 costs incurred by facilities throughout the state and adjusted for inflation (***Pinnacle Nursing Home v Axelrod***, *supra*, 719 F.Supp. at 1176).

THE CHALLENGED ASSESSMENTS

In 1990 the Legislature enacted PHL § 2807-d to provide that hospitals, which as defined in the article includes RHCFs, are to be "charged assessments on their gross receipts received from all patient care services . . . on a cash basis in the percentage amounts and for the periods specified in subdivision two of this section" (PHL § 2807-d[1][a]). Subdivision 2(b)(i) provided that for RHCFs the assessment

shall be 0.6% of gross receipts during the period of January 1, 1991 through March 31, 1992. Plaintiffs assert, and defendants acknowledge, that the assessment was imposed for the purpose of eliminating the budget deficit for the fiscal year 1990 – 1991 and that the funds collected are credited to the general fund. This "original" assessment of 0.6% is *not* in issue.

In 1992 the Legislature amended the statute by eliminating the March 31, 1992 sunset date for the 0.6% assessment and imposing an additional assessment of 1.2% on gross receipts received beginning April 1, 1992 (PHL § 2807[2][b][ii]). The legislation included a provision whereby, for purposes of computing Medicaid reimbursement rates for services rendered by RHCFs, the 1.2% additional assessment "shall be a reimbursable cost to be reflected as timely as practicable in rates of payment applicable within the assessment period, contingent on . . . federal financial participation . . ." (PHL § 2807-d[10][b]).

PHL § 2807-d(2)(b) was again amended in 1995 to add a "further additional assessment" of 3.8% on gross receipts received by RHCFs for the period of July 1, 1995 through March 31, 1996. Subdivision 10(b) was also amended to provide that the 3.8% assessment shall also be a reimbursable cost to be reflected in Medicaid payment rates, contingent on federal financial participation. Both parties acknowledge that the 1.2% and 3.8% assessments were imposed to meet the State's budgetary needs.[1]

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1. Additional assessments imposed for the 1996-1997 fiscal year are being challenged in a separate action, entitled *Port Jefferson Health Care Facility v Wing*, Index No. 96-25152.

Appendix D

PLAINTIFF'S ARGUMENT

The tax assessments imposed by PHL § 2807-d are not uniformly applied to all RHCFs, despite the fact that all are engaged in the same activity and, by federal regulation, all are required to provide the same quality of care to each resident in their facilities, regardless of the source of the residents' income (42 CFR § 483.12[7][c]). As a result, some RHCFs must pay more than their "fair share" of the tax burden. In particular, those facilities having a large Medicaid population have the majority of their revenues "held harmless" from the assessments (i.e., the effective rate is 0.6%); in contrast, RHCFs like the plaintiffs, having a large proportion of gross receipts from non-Medicaid sources, must shoulder the full burden of the assessments (the effective rate is 5.6 %). Hence the greater the Medicaid population of a facility, the less is its assessment.

The mere source from which an RHCF receives payment for patient care bears no correlation to its profitability or ability to pay the assessments. In many cases facilities with greater Medicaid populations earn greater net profits per bed than those with lesser Medicaid populations. Put another way, facilities with large non-Medicaid populations are not inherently in a better position to pay the taxes. This is so because of the variety of factors that determine profit: ratio of employees to residents; rate of pay to employees, which correlates to geographic location and each employee's years of service; number of days with "bed vacancies."

Appendix D

DEFENDANTS' ARGUMENT

The assessment statute is consistent with equal protection requirements because it is rationally related to the legitimate state interest in raising revenue.

Defendants describe the assessment as "a broad-based tax which . . . applies equally to all nursing homes. The assessments apply on a cash basis to *all* gross receipts of nursing homes, regardless of . . . the source of the payment." For example, two nursing homes (A and B), each having gross receipts of $1,000,000 in fiscal year 1995-96, will pay the same tax ($56,000), even though A received all of its revenue from Medicaid while B received only half of its revenue from Medicaid. A nursing home's ability to recover the 1.2% and 3.8% assessments from the Medicaid program depends upon the number of days of service it provides to Medicaid patients. In the example above, A will recover more of the assessment than B because A rendered more days of service to Medicaid patients. "But, a law does not offend the Constitution simply because the distinctions it draws are imperfect or 'result in some inequality' " (*citing*, ***Schneider v Sobol***, 76 NY2d 309, 314, 559 NYS2d 221, 223 [1990]).

Defendants offer three rationales that may have been in the legislators' minds as justification for the inequality. First, facilities with a higher percentage of non-Medicaid patients "should have a greater ability to recover the assessment from non-Medicaid sources, such as by raising their private pay rates." Second, the Legislature may have made a rational determination that by making the assessments "reimbursable for Medicaid rate calculation purposes, the impact . . . on

RHCFs could be mitigated while substantial revenues could still be generated for the State to meet its budgetary requirements."[2] Third, reimbursement based upon the extent of participation in the Medicaid program acts as an incentive to nursing homes to provide care to those in need of State assistance for health care services.

PLAINTIFFS' COUNTER ARGUMENTS

RHCFs are not free to increase the rates they charge to non-Medicaid residents. Payment for care provided to non-Medicaid residents comes from a variety of sources, such as the Department of Veterans' Affairs (VA), Health Maintenance Organizations (HMOs), Medicare, long-term health care insurance policies, and private funds. RHCFs are legally bound to accept the fixed per diem rate contained in their contracts with the VA and the various HMOs to which they belong; these rates may not be adjusted to account for the assessments. Likewise fees paid for Medicare residents are set pursuant to a schedule which coincides with the level of care needed and is not cost-based; hence the cost of the assessments may not be included in the payment sought from Medicare. This leaves residents who pay for their care out of their own funds as the only ones who could be charged a greater rate. To require them to bear the burden of the assessments would be "untenable" and "reprehensible" and would result in "invidious discrimination" for the following reasons.

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2. The cost of the Medicaid program is shared by the federal, state and local governments, the state's share being 40%. Hence, according to defendants' example, if nursing homes are reimbursed $1,000,000 in Medicaid costs, only $400,000 of this will be state dollars, and the state receives a net benefit of $600,000.

First, private pay residents are already being charged the daily rate the market will bear; to increase the rate to the level necessary to recoup the assessments would be impracticable. As an example, one plaintiff (Port Chester Nursing Home) would have to raise its current annual rate for such patients by 16.05% (an amount equal to $13,070.53) to recoup its unreimbursable assessment payments. To do this would result in the loss of significant numbers of such residents to nearby facilities in Connecticut, New Jersey and Massachusetts, which do not impose similar assessments. Second, a raise in rates charged to these residents would hasten the depletion of their funds, thereby accelerating the time when they would be forced to rely upon Medicaid. Finally, private pay residents already pay rates "substantially greater than those paid by the VA, Medicare, Medicaid and HMOs"; hence they already greatly subsidize the care provided to all other Medicaid and non-Medicaid patients.

The second rationale offered, the suggestion that the statutory scheme may provide an incentive to take in more Medicaid patients, is belied by other legislation adopted in 1995 (L.1995, c.81) and 1996 (c.474, § 204). In accordance with the latter, each RHCF must yearly increase its Medicare utilization and decrease its Medicaid utilization by 2% or be subject to a penalty in the form of a reduction in its Medicaid rate. As to the third potential rationale, the mere fact that a taxing statute may be effective in raising revenue does not render it immune from equal protection scrutiny where it violates the equal protection rights of members of the taxed class. Although legislatures possess great freedom of classification in the field of taxation (***Shapiro v City of New York***, 32 NY2d 96, 343 NYS2d 323, 328 [1973]), once the

legislature has identified and selected the class to be taxed, equal protection "requires the same means and methods to be applied impartially to all the constituents of each class, so that the laws operate equally and uniformly upon all persons in similar circumstances" (***Cincinnati, N.O. & T.P.R. Co. v Commonwealth***, 115 U.S. 321, 337 [1885]; ***People v Reardon***, 184 NY 431, 445 [1906], *aff'd* 204 U.S. 152, 27 S.Ct. 188 [1907]).

EVIDENTIARY FACTS

To comply with the Boren Amendment in 1995 the New York State Department of Health (DOH) submitted to the Secretary of Health and Human Services a report entitled "Nursing Home Efficiency Analysis and Findings." The analysis is based upon 1993 cost data for all nursing homes in the State, except those having no payment rate for that year or not operating for the full year. Of the total of 584 nursing homes, 292 were identified as EEOFs. The EEOFs are listed by name with the actual per diem rate paid in 1995 and the calculated "necessary cost" for 1995. In every instance the DOH found that the Medicaid rate paid to EEOFs in 1995 exceeds each one's calculated necessary costs, often by 25%, and a number by as much as 60%.

The parties acknowledge that the challenged assessments were imposed to close budget gaps which stem, in large part, from the enormous cost of the State's Medicaid program. According to an Executive Memo dated June 20, 1995, issued in connection with the passage of Medicaid and welfare reform, "more than $24 billion in Federal, State and local monies were spent during the past fiscal year to provide

health care services to our Medicaid population." The memo further states that the legislation enacted "will cut the State's share of Medicaid payments to nursing homes by approximately $110 million . . . [by] limiting reimbursement for administrative costs and promoting nursing home efforts to maximize revenues outside the Medicaid program."

To dispel the notion that RHCFs with greater numbers of non-Medicaid residents are inherently more profitable than those with lower non-Medicaid populations, plaintiffs submit financial data from selected RHCFs for 1995, given in the chart below as rounded to the nearest dollar. The facilities listed in the chart are the Port Jefferson Health Care Facility (PJHCF, 120 beds), the Glengariff Health Care Center (GHCC, 262 beds), the Port Chester Nursing Home (PCNH, 160 beds), the Holliswood Care Center (HCC, 314 beds), and the Albany Avenue Nursing Home (AANH, 22 beds). The second column is the average Medicaid population of each facility for 1995. It is easily seen that two of the facilities (GHCC and HCC) had nearly equal gross revenues, but the one with the higher Medicaid population earned a substantially higher net profit.

Facility	Medicaid	Gross Revenue	Total Ass'nt	Net Profit per bed
PJHCF	63%	$ 7,644,303	$269,406	$1,768
GHCC	67%	$17,084,409	$687,752	$2,407
PCNH	84%	$ 8,911,678	$484,948	$ 53
HCC[3]	90%	$17,306,989	$731,349	$4,116
AANH	0%	$ 861,072	$ 52,152	$ 422

3. Not a plaintiff in this action, Holliswood is listed for the purpose of demonstrating plaintiffs' point.

Appendix D

As against plaintiffs' claim that they are disproportionately burdened by the assessments, defendants show that plaintiffs' "cost report data" for 1995 demonstrate that the percentage of days of service rendered to Medicaid patients is close to the statewide average of 80%, and for four plaintiffs the percentage equals or exceeds the statewide average. For the first three nursing homes in the above chart, their respective percentages of Medicaid days are 72%, 66% and 79%.

PRINCIPLES RELEVANT TO TAX STATUTES

We begin with the recognition that every legislative enactment enjoys a strong presumption of constitutionality which, although rebuttable, requires the challenger to demonstrate that the enactment is unconstitutional beyond a reasonable doubt (***Pharmaceutical Manufacturers Association v Whalen***, 54 NY2d 486, 446 NYS2d 217, 220 [1981]). Particularly in the area of taxation, "the Legislature has very nearly unconstrained authority in the design of taxing impositions," subject only to "constitutional inhibitions" (***Matter of Long Island Lighting Company v State Tax Commission***, 45 NY2d 529, 410 NYS2d 561, 563 [1978]). Moreover, "fairness and equity are not the principal criteria against which the validity of tax statutes is to be determined," and it "is often immaterial . . . that in application a particular statute or regulation works even a flagrant unevenness. . . ." (***LILCO v Tax Commission***, ***supra***).

"Neither the due process clause nor the equal protection clause imposes any rigid limitations upon the State's power

to devise reasonable tax policies" (***Association of the Bar of the City of New York v Lewisohn***, 34 NY2d 143, 356 NYS2d 555, 564 [1974]). Hence the equal protection clause "does not forbid classification; and the power of the state to classify for purposes of taxation is of wide range and flexibility provided always that the classification 'must be reasonable, not arbitrary' " (***Louisville Gas & Electric Co. v Coleman***, 277 U.S. 32, 37, 48 S.Ct. 423, 425). "But there is a point beyond which the State cannot go without violating the Equal Protection Clause. The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary" (***Allied Stores v Bowers***, 358 U.S. 522, 527, 79 S.Ct. 437, 441; *see also*, ***Trump v Chu***, 65 NY2d 20, 489 NYS2d 455, 459 [1985]; ***Foss v City of Rochester***, 65 NY2d 247, 491 NYS2d 128, 133 [1985]).

In order to be reasonable, the classification "must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. . . . That is to say, . . . the attempted classification 'must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis' " (***Louisville Gas & Electric Co. v Coleman***, *supra*). "That a statute may discriminate in favor of a certain class does not render it arbitrary if the discrimination is founded upon a reasonable distinction, or difference in state policy" (***Allied Stores v Bowers***, *supra*). "It has long been settled that a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause . . . if any state of facts reasonably can be conceived, that would sustain it"

Appendix D

(***Allied Stores v Bowers***, *supra*; ***Assn. of the Bar v Lewisohn***, *supra*).

In ***Stewart Dry Goods Co. v Lewis*** (294 U.S. 550, 55 S.Ct. 525), the United States Supreme Court declared a tax on gross receipts unconstitutional based upon findings that "the gross sales of a merchant do not bear a constant relation to his net profits." The Court stated, at 294 U.S. 558,

> The difference in effect between a tax measured on gross receipts and one measured by net income . . . is manifest and substantial . . . A tax upon gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. Conceivably it may be sufficient to make the difference between profit and loss, or to so diminish the profit as to impede or discourage the conduct of the commerce. A tax upon the net profits has not the same deterrent effect, since it does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large.

The assessments on gross receipts in the instant matter depletes assets which are earmarked for the provision of health care services to those in plaintiffs' facilities. In the case of plaintiff Albany Avenue Nursing Home, which is not licensed to provide care to Medicaid patients, none of its 1995 assessment of $52,142 was reimbursed. The administrator of the facility avers that its 1995 "pre-assessment net profit of $60,583.35 plummeted to $8,441.35"

and that but for "a non-recurring insurance recovery . . . [the facility] would have suffered a net loss of $2,043.02 by virtue of the challenged assessments." Hence what the Supreme Court found "conceivable" in the ***Stewart Dry Goods*** case is reality for at least one plaintiff. As to defendants' contention that plaintiffs are close to the statewide average in Medicare days of service, averages are often misleading.

By providing for reimbursement of the assessments based upon the extent of a facility's Medicaid participation, the State is acting at odds with its efforts to reduce its Medicaid costs. More important, by taxing gross receipts rather than net income, the burden falls more heavily on some RHCFs than others. In contrast, a tax on income "*by its very nature assures equality of treatment*, burden of the exaction varies with increase or decrease of return on capital invested and with the comparative success or failure of the enterprise" (***Stewart Dry Goods Co. v Lewis***, *supra*, 294 U.S. at 560, emphasis added). Defendants advance no argument that the inequality resulting from the imposition is justified by any reason of policy; their only premise is that the tax is rationally related to the State's interest in raising revenue.

The evidence dispels the three rationales proffered by defendants, and the court can think of no other "state of facts" which would sustain the unequal treatment. Hence plaintiffs are entitled to the declaratory and injunctive relief sought.

With respect to the request that plaintiffs' assessments be refunded, the general rule is that the payment of a tax or fee cannot be recovered subsequent to the invalidation of the taxing statute or rule, unless the taxpayer can demonstrate

that the payment was involuntary (***Video Aid Corp. v Town of Wallkill***, 85 NY2d 663, 628 NYS2d 18, 20 [1995]; ***Imperial Gardens, Inc. v Town of Wallkill***, __ AD2d __, 644 NYS2d 528, 530 [2d Dept 1996]). That payments were involuntary may be shown by writing "under protest" on the checks tendered to defendants (*supra*) or by the pendency of a legal proceeding at the time of payment in each year for which recovery is sought (***Corporate Property Investors v Board of Assessors of County of Nassau***, 153 AD2d 656, 545 NYS2d 166 [2d Dept 1989], *appeal dismissed in part, denied in part* 75 NY2d 802, 552 NYS2d 102, *aff'd sub nom.* ***Matter of Bowery Savings Bank v Board of Assessors***, 80 NY2d 961, 590 NYS2d 876 [1992]).

In the instant matter there is only an affidavit in which the owner/operator of two of the plaintiff nursing homes that payment of the assessments by those two facilities was made "under protest." He further states that "on information and belief" the other plaintiffs have also paid under protest. Because "appropriate legal protest *prior to or at the time of payment* is a prerequisite to recovery in an action seeking refunds" (***Corporate Prop. Investors v Board of Assessors***, *supra*, 545 NYS2d at 169), the request for the return of assessments paid is denied, without prejudice to renewal upon proof that each plaintiff paid "under protest" for each year in which the assessments were collected. If only some plaintiffs paid "under protest" or some began later than others, any refund warranted may be had only from the time of the first payment "under protest."

Finally, pursuant to 42 U.S.C. § 1988, the successful party in a § 1983 action may be awarded attorneys' fees. A

§ 1983 action is one seeking redress for the deprivation of any of the rights, privileges or immunities secured by the Constitution of the United States when such derivation occurs by a person or persons acting "under color of state law." State officials acting pursuant to a state statute are acting "under color of state law" for purposes of a § 1983 action regardless of whether the law gave them any discretion in carrying out their duties (***Jackson v Galan***, 868 F.2d 165 [1989]). Therefore, contrary to defendants' contention, the instant action qualifies as a § 1983 action and to the extent plaintiffs have succeeded thus far, they are entitled to attorneys' fees pursuant to § 1988.

In sum, the defendants' cross-motion is denied and plaintiffs' motion is granted, to the extent indicated above. The court finds and declares that the 1.2% and 3.8% assessments on gross receipts pursuant to Public Health Law § 2807-d(2)(b)(ii) and § 2807-d(2)(b)(iii) are unconstitutional as violative of plaintiffs' rights to equal protection of the law. Accordingly, defendants are directed to cease collecting the assessments as of the month of June, 1997.

The remaining causes of action in the amended complaint are severed and continued.

Submit order/judgment providing for costs and expenses incurred thus far in the action, together with an attorney's affidavit of services rendered setting forth the work performed, the hours spent, and the rate charged.

s/ Lawrence Newmark
LAWRENCE NEWMARK, J.S.C.

APPENDIX E — COUNTER PROPOSED ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK DATED AUGUST 27, 1997

At an I.A.S. Term, Part 8 of the Supreme Court of the State of New York, held in and for the County of Suffolk, at the Courthouse located at 235 Griffing Avenue, Riverhead, New York 11901 on the 27 day of Aug, 1997.

PRESENT:

HON. LAWRENCE NEWMARK, J.S.C.

Index No. 95-23917

PORT JEFFERSON HEALTH CARE FACILITY, BIRCHWOOD HEALTH CENTER, CARILLON HOUSE NURSING FACILITY, LITTLE FLOWER NURSING HOME, NESCONSET NURSING CENTER, PATCHOGUE NURSING CENTER, PETITE FLEUR NURSING HOME, ST. JAMES NURSING HOME, ST. JAMES PLAZA NURSING FACILITY, SUNREST HEALTH FACILITIES, INC., RIVERHEAD NURSING HOME, CENTRAL ISLAND HEALTH CARE, GLENGARIFF HEALTH CARE CENTER, GRACE PLAZA OF GREAT NECK, INC., SOUTH SHORE HEALTHCARE, SUNHARBOR MANOR, WOODBURY NURSING HOME, PORT CHESTER NURSING HOME, MAPLEWOOD NURSING HOME, MEADOWBROOK NURSING HOME and ALBANY AVENUE NURSING HOME,

Plaintiffs,

– against –

Appendix E

BRIAN J. WING, as Acting Commissioner of Social Services of the State of New York, BARBARA ANN DeBUONO, M.D., M.P.H., as Commissioner of Health of the State of New York, and the STATE OF NEW YORK,

Defendants.

COUNTER PROPOSED ORDER

Plaintiffs, having duly moved pursuant to CPLR 3212 for summary judgment on the Second and Eleventh Causes of Action set forth in the Amended Complaint granting relief as follows:

1. declaring N.Y. Public Health Law §2807-d(2)(b)(ii) unconstitutional as violative of plaintiffs' rights to the equal protection of the laws under the United States and New York State Constitutions;

2. declaring 1995 N.Y. Laws, c. 2, §136, codified at N.Y. Public Health Law §2807-d(2)(b)(iii), unconstitutional as violative of plaintiffs' rights to the equal protection of the laws under the United States and New York State Constitutions;

3. permanently enjoining defendants from collecting the 1.2% "additional assessments" and the 3.8% "further additional assessments" and requiring defendants to refund any and all amounts collected from plaintiffs pursuant thereto, insofar as such amounts have been paid under protest; and

4. awarding costs, including plaintiffs' attorneys' fees, pursuant to 42 U.S.C. §1988, together with disbursements and such other and further relief which the Court may deem just and proper; and

Defendants, having duly cross-moved for summary judgment dismissing the Second and Eleventh Causes of Action in their entirety and directing a hearing on the attorneys' fees incurred by the defendants in the opposition of this action, together with such other and further relief as the Court may deem proper;

And the motion and cross-motion having been duly submitted to the Court on March 26, 1997;

And upon reading and filing the plaintiffs' notice of motion for summary judgment, dated October 9, 1996, together with the affidavits and the exhibits annexed thereto; and

UPON reading and filing the defendants' notice of cross-motion for summary judgment, dated December 2, 1996, with the exhibits annexed thereto; and

UPON reading and filing the reply affidavit of Wayne Benach, sworn to February 13, 1997, with the exhibits annexed thereto, and after due deliberation, the court having rendered its decision, dated June 30, 1997, and

UPON reading and filing the affirmation of Susan M. Connolly, dated July 28, 1997, together with the accompanying Memorandum of Law,

Appendix E

NOW, upon motion of Dennis C. Vacco, Attorney General of the State of New York, attorney for defendants, it is hereby

ORDERED, that defendants' cross-motion is in all respects is denied; and it is further

ORDERED, that plaintiffs' motion is granted in part as hereinafter provided; and it is further

ORDERED AND DECLARED, that N.Y. Public Health Law §2807-d(2)(b)(ii) and N.Y. Public Health Law §2807-d(2)(b)(iii) are unconstitutional as violative of plaintiffs' rights to equal protection of the laws under the United States and Now York State Constitutions; and it is further

ORDERED, that defendants cease collecting the assessments as of the month of June 1997; and it is further

ORDERED, that the request for the return of the assessments is denied, without prejudice to renewal upon proof that each plaintiff paid "under protest" for each year in which assessments were collected, and any return of monies paid is available only from the time of the first payment "under protest"; and it is further

ORDERED, that plaintiffs' request for attorney's fees is granted, with the amount to be fixed in a further order following a Conference to be held at Part 8 on September 17, 1997 at 9:30 AM and submission of a further affirmation and records detailing services rendered only for the instant

action and no other matters, together with costs and fees, to June 30, 1997, the date of the Court's decision, pursuant to 42 U.S.C. §1988; and it is further

ORDERED, that each of the nine remaining causes of action set forth in the Amended Complaint are expressly severed for further proceedings.

ENTER,

s/ LAWRENCE NEWMARK
HON. LAWRENCE NEWMARK,
J.S.C.

APPENDIX F — RELEVANT STATUTES

NEW YORK STATE STATUTES INVOLVED

1990 N.Y. Laws, c. 938, § 28, codified at former New York State Public Health Law § 2807-d(1)(a) provides:

> Hospitals, as defined in this article, . . . are charged assessments on their gross receipts received from all patient care services and other operating income, less personal needs allowances and refunds, on a cash basis in the percentage amounts and for the periods specified in subdivision two of this section. Such assessments shall be submitted by or on behalf of hospitals to the commissioner or his designee.

1990 N.Y. Laws, c. 938, § 28, codified at former New York State Public Health Law§ 2807-d(2)(b)(i) provides:

> For residential health care facilities the assessment shall be six-tenths of one percent of each residential health care facility's gross receipts received from all patient care services and other operating income on a cash basis beginning April first, nineteen hundred ninety-one for hospital or health-related services, including adult day services.

1992 N.Y. Laws, c. 41, § 5, codified at former New York State Public Health Law § 2807-d(2)(b)(ii) provides:

> For residential health care facilities an additional assessment shall be one and two-tenths

> percent of each residential health care facility's gross receipts received from all patient care services and other operating income on a cash basis beginning April first, nineteen hundred ninety-two for hospital or health-related services, including adult day services.

1995 N.Y. Laws, c. 2, § 136, codified at former New York State Public Health Law § 2807-d(2)(b)(iii) provides in pertinent part:

> For residential health care facilities a further additional assessment shall be three and eight tenths percent of each residential health care facility's gross receipts received from all patient care services and other operating income on a cash basis for the period of July first, nineteen hundred ninety-five through March thirty-first, nineteen hundred ninety-six for hospital or health-related services, including adult day services.

1995 N.Y. Laws, c.2, § 139, codified at former New York State Public Health Law § 2807-d(10)(a) and(b) provides:

> Notwithstanding any inconsistent provision of law or regulation to the contrary:
>
> (a) the assessments pursuant to this section shall not be an allowable cost in the determination of reimbursement rates pursuant to this article;
>
> (b) provided, however, that for purposes of determining rates of payment pursuant to this

article for residential health care facilities, the additional assessment of one and two-tenths percent and the further additional assessment of three and eight-tenths percent imposed pursuant to this section shall be a reimbursable cost to be reflected as timely as practicable in rates of payment applicable within the assessment period, contingent, for payments by governmental agencies, on all federal approvals necessary by federal law and regulations for federal financial participation in payments made for beneficiaries eligible for medical assistance under title XIX of the federal social security act.